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FOR SECRETARY SHULTZ FROM AMBASSADOR GALBRAITH

PASS TO NSC FOR JUDGE CLARK

E.O. 12356: DECL: OADR
TAGS: ENG, EEWT, NO, UR
SUBJ: ALTERNATIVE ENERGY MISSION: SUMMARY

1. (C) ENTIRE TEXT.

2. ABOUT SIX MONTHS HAVE PASSED SINCE I BEGAN MY ALTERNATIVE ENERGY MISSION, AND I WOULD LIKE TO OFFER A BRIEF SUMMARY OF MY FINDINGS BASED ON DISCUSSIONS WITH GOVERNMENT AND INDUSTRY OFFICIALS IN FRANCE, GERMANY, THE UK, THE NETHERLANDS, AND NORWAY. I WOULD ALSO LIKE TO SUGGEST WHERE WE SHOULD GO FROM HERE.

3. THE DEVELOPMENT OF NORWEGIAN GAS DEPENDS FUNDAMENTALLY ON THE AVAILABILITY OF WILLING SELLERS AND WILLING BUYERS. DESPITE CURRENT UNCERTAINTIES IN THE EUROPEAN GAS MARKET PROMPTED BY THE RECENT DECLINE IN DEMAND, THE MAJOR EUROPEAN GAS DISTRIBUTORS ARE CONVINCED THAT THEY WILL NEED SUBSTANTIAL ADDITIONAL QUANTITIES OF GAS (PROBABLY AROUND 50 BCM FOR THE CONTINENT ALONE) BY THE END OF THE 1990'S WHICH HAVE NOT YET BEEN CONTRACTED FOR. THE DISTRIBUTORS ARE LOOKING AT ALL VIABLE SOURCES, BUT THE LARGEST SUPPLIES ARE IN THE SOVIET UNION AND NORWAY. THE NORWEGIAN GOVERNMENT HAS GIVEN ASSURANCES IT IS WILLING TO BE A MAJOR SUPPLIER OF GAS FOR EUROPE IN THE 1990'S AND THE OWNERS OF SLEIPNER AND TROLL ARE ANXIOUS TO SELL. I HAVE NO DOUBT THAT THE CURRENT NEGOTIATIONS ON SELLING SLEIPNER GAS WILL BE SUCCESSFUL AND SLEIPNER WILL BE DEVELOPED. (CURRENT CONSENSUS SEEMS TO BE THAT THE UK WILL SUCCEED IN BUYING MOST OF THIS GAS; VERY LITTLE WILL GO TO THE CONTINENT.) THE DEVELOPMENT OF THE TROLL FIELD IS ALSO PROBABLE, BUT LESS CERTAIN, BECAUSE OF HIGH COST AND TECHNICAL PROBLEMS. THIS HIGH COST OF THE TROLL GAS MEANS THAT THE EUROPEANS COULD PROBABLY BUY GAS MORE CHEAPLY FROM

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THE SOVIETS THAN FROM THE NORWEGIAN TROLL FIELD TO FILL THEIR NEEDS THROUGH THE END OF THE 1990'S AND BEYOND. HOWEVER, THIS WOULD ENTAIL A SIGNIFICANT INCREASE IN THE PERCENTAGE OF THEIR DEPENDENCE ON THE SOVIET UNION.

4. THE MAJOR EUROPEAN DISTRIBUTORS CLAIM THEY ARE NOT SEEKING TO CONTRACT FOR MORE SOVIET GAS AND THEY PROFESS A COMMITMENT TO TROLL GAS. IT IS TOO EARLY TO CONTRACT FOR THIS GAS, HOWEVER, AND SOVIET STICKS AND CARROTS WILL BE AT WORK BETWEEN NOW AND THEN. (ONCE THE NEW SOVIET EXPORT LINE IS COMPLETED THE SOVIETS' EXCESS GAS AND TRANSMISSION CAPACITY WILL ALLOW THEM TO OFFER GAS WHOSE INCREMENTAL COST TO THE SOVIET UNION IS ALMOST ZERO.) THE FUTURE PRICE OF OIL IS ALSO A POTENTIAL THREAT TO THE DEVELOPMENT OF TROLL; INDEED, A PRECIPITOUS DROP IN PRICE COULD KILL IT. THE OPTIMISTIC VIEW OF THE DEVELOPMENT OF TROLL IS BASED ON AN ASSUMPTION THAT THE EUROPEAN GOVERNMENTS WOULD NOT ALLOW THEMSELVES TO GO BEYOND A CERTAIN LEVEL (30 PERCENT) OF DEPENDENCE ON THE SOVIET UNION AS A SOURCE OF NATURAL GAS NO MATTER WHAT PRICES ARE OFFERED BY THE SOVIETS OR WHAT HAPPENS TO OIL PRICES; THIS MAY BE DANGEROUS WISHFUL THINKING.

5. AS LONG AS A LIMIT ON DEPENDENCE ON THE SOVIET UNION REMAINS AN ASSUMPTION AND NOT REALITY, WE ARE FACED WITH THE VERY REAL POSSIBILITY THAT IN AN ERA OF WEAK OIL PRICES THE SOVIET UNION WILL FINALLY UNDERBID THE NORWEGIANS AND PREVENT THE DEVELOPMENT OF TROLL. AFTER DUTCH SUPPLIES RUN DOWN, THE SOVIETS COULD THEN FIND THEMSELVES IN A POSITION TO CONTROL THE EUROPEAN MARKET. THE EUROPEAN GAS DISTRIBUTORS HAVE TO MAKE THEIR PURCHASE CONTRACT DECISIONS ON A COMMERCIAL BASIS. ALTHOUGH THEY ARE RELUCTANT TO BE OVERLY DEPENDENT ON ANY ONE SOURCE, THEY GENERALLY VIEW THE SOVIET UNION AS A RELIABLE SUPPLIER, AND IF THEY HAD THE POLITICAL GO-AHEAD TO DO SO, THEY MIGHT NOT BE ADVERSE TO INCREASING THEIR DEPENDENCE ON THE SOVIET UNION. OTHERWISE, THEY MIGHT LOSE THEIR CUSTOMERS TO FUEL OIL. IT IS ALSO POSSIBLE THAT THE UK WILL BID SO AGGRESSIVELY FOR THE TROLL GAS AND DRIVE THE PRICE SO HIGH THAT THE CONTINENTAL BUYERS WILL BE CLOSED OUT.
THEY COULD THEN ARGUE THEY WERE FORCED TO BUY MORE SOVIET GAS TO MEET THEIR NEEDS.

6. TO AVOID THIS POSSIBILITY, WE NEED A POLITICAL COMMITMENT NOW FROM THE GOVERNMENTS OF THE EUROPEAN GAS-CONSUMING NATIONS THAT, OVER THE LONG TERM, THEY WILL LIMIT THEIR PURCHASES OF SOVIET GAS -- IDEALLY THAT THEY WILL PURCHASE NO MORE SOVIET GAS BEYOND

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WHAT THEY HAVE ALREADY CONTRACTED FOR. SUCH A POLICY WOULD ASSURE THE DEVELOPMENT OF THE TROLL FIELD AND WOULD PREVENT OUR BEING FACED IN A FEW YEARS WITH ANOTHER EUROPEAN-SOVIET GAS DEAL. THE EUROPEANS WOULD BE AGREEING, IN EFFECT, TO PAY A "SECURITY PREMIUM" FOR THE MORE EXPENSIVE NORWEGIAN GAS.

7. I AM STILL PONDERING THE VARIOUS APPROACHES WE MIGHT TAKE TO GETTING SUCH AN AGREEMENT AND THE PROS AND CONS OF THE VARIOUS FORMS SUCH A COMMITMENT MIGHT TAKE. WE MUST BEAR IN MIND THAT THE EUROPEANS ARE LIKELY TO ASK WHAT WE HAVE TO OFFER TO COMPENSATE FOR THE HIGHER GAS PRICES THEY WILL BE PAYING. WE MUST ALSO AVOID CREATING A SITUATION SO FAVORABLE TO THE NORWEGIANS THAT THEY ARE ABLE TO MAKE WINDFALL PROFITS AT THE EXPENSE OF THEIR ALLIES.

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8. THESE THOUGHTS OBVIOUSLY NEED MORE DEVELOPMENT. I LOOK FORWARD TO DISCUSSING THEM WITH YOU AND WITH MY COLLEAGUES FROM OTHER EUROPEAN CAPITALS AT THE COM CONFERENCE NEXT MONTH.
GALBRAITH
END OF MESSAGE CONFIDENTIAL